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## Only the exports seem to increase

**According to the forecast of GKI Economic Research Co., in 2011 external demand has been somewhat better than expected, however, uncertainty in the global economy has been greater than usual. This uncertainty is caused by the unpredictable political situation affecting the price of oil, changes in commodity prices, the sovereign debt crisis in some EU countries and the possible aftermath of Japan's nuclear disaster. The decline in domestic demand in Hungary has been over; however, stagnation prevails in this sphere. External disequilibria continue to improve. The general government deficit (excluding the nationalized pension fund assets) has changed as envisaged, and, taking into account the freezing of expenditures, its size will probably be as projected.**

In the first quarter of 2011 the Hungarian economy still increased at a rate lower than the EU average (2.2 per cent versus 2.5 per cent). In addition to the 7-8 per cent increases in the Estonian and Lithuanian economies that experienced double-digit declines in 2009, GDP growth rates in Germany (4.8 per cent), Austria (4 per cent) and Slovakia (3.6 per cent) are also remarkable. While the decline in Greece and Portugal has continued, Romania has already experienced stagnation.

Growth of the Hungarian economy can be attributed almost solely to net exports. While industrial exports increased by 17 per cent, the volume of domestic sales decreased by 5 per cent. Although exports increased faster in 2011 than in 2010, there was a slowdown in March compared with the first months, and industrial expectations deteriorated significantly in May. This means that some slowdown can be expected in the coming months. The decline in construction has continued since 2006, in the first quarter of 2011 gross production went down by 7 per cent as the combined result of a 2 per cent drop in structural engineering and a 14 per cent fall in civil engineering. In particular, investments funded by the government and households contracted. The number of homes completed fell by more than a third and the number of construction permits issued dropped by half. In general, services most probably stagnated; however, tourism driven by external demand was able to grow. Though domestic turnover of tourism also increased due to the demand of those with higher incomes, the number of foreigners' overnight stays grew faster (7 per cent) than that of Hungarians (5 per cent). The retail sales stagnated in the first quarter of 2011. The proportion of non-paying loans has been increasing in the financial sector, and crisis taxes (which are much higher in Hungary than in other countries) as well as nonperforming mortgage loans restrain the activity in the financial sector, thereby recovery. In the first quarter of 2011 the stocks of residential housing and consumer loans as well as corporate loans declined, while lending conditions for the latter one tightened. In addition to the low profitability of banks, this was also caused by the rising costs and shrinking availability of financial sources denominated in foreign currencies.

Important features of the government's economic policy have been the fighting for a larger room of manoeuvring (that is, for an increase in indebtedness) and the use of unconventional (nationalizing, populist and unconstitutional) economic instruments. In the spring of 2011 the announcement of Szell Kalman Plan and later the convergence plan represented important steps into the right direction. The main aim now is to create a sustainable balance. However, the new policy is still in the rough, and the ideas that have become known excessively focus on curbing social transfers and on traditional budgetary restrictions instead of institutional and operational reforms. Some parts of the steps already announced have met strong social resistance, while double talk has continued; there has been no declaration of an economic policy change, which in itself is limiting its feasibility.

The turnaround, however, has inspired cautious confidence among foreign investors. The slight strengthening of the HUF in the spring of 2011 was due to the high base rate and the favourable external balance, whereas its weakening in late May could be attributed to the new Greek (and euro) crisis. The general government deficit and financing targets for 2011-2012 now seem to be achievable as a consequence of the already

started economic policy change. Recent successful issuances of government bonds with high interest rate premiums support this statement. As a result of last year's unconventional economic policy the country's ability to attract capital and to generate economic growth weakened. The question of how to restore it is still waiting for an answer.

## The forecast of GKI Economic Research Co.: the Hungarian economy in 2011

	2008	2009	2010	March 2011	2011 (forecast)
1. Volume of GDP (previous year=100)	100.8	93.3	101.2	-	102.5
2. Industrial production (constant prices, previous year=100)	98.9	82.3	110.5	112.2	109
3. Investments in the national economy (constant prices, previous year=100)	100.4	93.5	94.4	-	101
4. Construction (constant prices, previous year=100)	94.9	95.7	89.9	93.0	95
5. Retail trade (volume index, previous year=100)	98.2	94.8	97.7	99.8	101.3
6. Exports (current prices in euro, previous year=100)	106.3	80.6	121.4	123.4	117
7. Imports (current prices in euro, previous year=100)	106.6	75.2	119.4	121.6	118
8. Trade balance (EUR billion)	-0.6	3.4	5.5	2.1	5.7
9. Balance of the current and capital account (EUR billion)	-6.8	1.4	3.8	-	3.7
10. Average exchange rate of euro (in HUF)	251.2	280.6	275.4	270.6*	272
11. Deficit of the general government (cash flow basis, without local governments; HUF billion)**	909	918.6	870	666.2*	690
12. Index of average gross earnings	107.5	100.5	101.4	101.5	104.0
13. Consumer price index	106.1	104.2	104.9	104.3*	104.2
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.6	104.7	104.7*	104
15. Rate of unemployment (at the end of the period, per cent)	8.0	10.5	10.8	11.6	10.7

\* January-April 2011

\*\* Including the HUF528bn pension fund takeover, and without corporate consolidation and MOL purchase expenditures  
Sources of actual data: HCSO, NBH, MoF